1958

THE SENATE OF CANADA

PROCEEDINGS

OF THE

STANDING COMMITTEE

ON

BANKING AND COMMERCE

To whom was referred the Bill (C-39) intituled: "An Act to amend the Income Tax Act".

The Honourable SALTER A. HAYDEN, Chairman

TUESDAY, AUGUST 26, 1958

WITNESSES:

K. Eaton, Assistant Deputy Minister, Taxation Division, Department of Finance; Mr. D. H. Sheppard, Assistant Deputy Minister, Division, Department of National Revenue; Mr. J. F. Harmer, Director, Assessments Branch, Taxation Division, Department nal Revenue; Mr. E. S. MacLatchy, Assistant Director, Legal Taxation Division, Department of National Revenue.

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OTTAWA, 1958

62448-6—1½

BANKING AND COMMERCE

The Honourable Salter Adrian Hayden, *Chairman*

The Honourable Senators

*Aseltine	Golding	Paterson
Baird	Gouin	Pouliot
Beaubien	Haig	Power
Bouffard	Hardy	Pratt
Brunt	Hayden	Quinn
Burchill	Horner	Reid
Campbell	Howard	Robertson
Connolly	Howden	Roebuck
(*Ottawa West*)	Hugessen	Taylor (*Norfolk*)
Crerar	Isnor	Turgeon
Croll	Kinley	Vaillancourt
Davies	Lambert	Vien
Dessureault	Leonard	White
Emerson	*Macdonald (*Brantford*)	Wilson
Euler	McDonald	Wood
Farquhar	McKeen	Woodrow—49.
Farris	McLean	
Gershaw	Monette	

(Quorum 9)

**ex officio* member.

ORDER OF REFERENCE

Extract from the Minutes of Proceedings of the Senate for Thursday, August 21st, 1958.

"Pursuant to the Order of the Day, the Honourable Senator Thorvaldson moved, seconded by the Honourable Senator Aseltine, that the Bill C-39, intituled: An Act to amend the Income Tax Act, be read the second time.

After debate, and—

The question being put on the motion, it was—

Resolved in the affirmative.

The Bill was then read the second time.

The Honourable Senator Thorvaldson moved, seconded by the Honourable Senator Pearson, that the Bill be referred to the Standing Committee on Banking and Commerce.

The question being put on the motion, it was—

Resolved in the affirmative."

J. F. MacNEILL,
Clerk of the Senate.

62448-6—1½

MINUTES OF PROCEEDINGS

TUESDAY, August 26, 1958.

Pursuant to adjournment and notice the Standing Committee on Banking and Commerce met this day at 8.00 p.m.

Present: The Honourable Senators: Hayden, *Chairman;* Aseltine, Baird, Brunt, Burchill, Croll, Euler, Golding, Gouin, Haig, Isnor, Leonard, Macdonald, Pouliot, Power, Taylor (*Norfolk*), White and Woodrow—18.

In attendance: Mr. E. R. Hopkins, Law Clerk and Parliamentary Counsel, the Senate, and the Official Reporters of the Senate.

Bill C-39, An Act to amend the Income Tax Act, was read and considered clause by clause.

The following witnesses were heard and questioned:—

Dr. A. K. Eaton, Assistant Deputy Minister, Taxation Division, Department of Finance, Mr. D. H. Sheppard, Assistant Deputy Minister, Taxation Division, Department of National Revenue, Mr. J. F. Harmer, Assistant Director, Assessment Branch, Taxation Division, Department of National Revenue, Mr. E. S. MacLatchy, Assistant Director, Legal Branch, Taxation Division, Department of National Revenue.

It was resolved to report the Bill without any amendment.

On motion of the Honourable Senator Croll, seconded by the Honourable Senator Aseltine it was resolved to report recommending that authority be granted for the printing of 800 copies in English and 200 copies in French of the Committee's proceedings on said Bill.

At 10.30 p.m. the Committee adjourned until tomorrow, Wednesday, August 27th, at 10.30 a.m.

Attest.

James. D. MacDonald,
Clerk of the Committee.

THE SENATE

STANDING COMMITTEE ON BANKING AND COMMERCE

EVIDENCE

OTTAWA, Tuesday, August 26, 1958

The Standing Committee on Banking and Commerce, to which was referred Bill C-39, an act respecting income tax, met this day at 8 p.m.

Senator Salter A. Hayden in the Chair.

The CHAIRMAN: Gentlemen, it is 8 o'clock and we have a quorum. We have two bills before us. The proposal is that we take the income tax amendments first.

We have with us tonight representing the several departments concerned, Mr. F. R. Irwin, of the Finance Department; Mr. D. H. Sheppard, of the Department of National Revenue and Mr. J. F. Harmer, of the Department of National Revenue, Income Tax Division; and of course with us tonight also is Dr. A. K. Eaton, Assistant Deputy Minister, Department of Finance.

I would like to have a preliminary motion for printing 800 copies of these proceedings in English and 200 in French.

Senator CROLL: I so move, Mr. Chairman.

Carried.

The CHAIRMAN: My suggestion in connection with the income tax amendments is that we go through them section by section.

Senator BRUNT: And get the explanations as we go along?

The CHAIRMAN: Yes. Mr. Harmer, we are going through these amendments section by section, and will you just tell us the purpose of each amending section and the reason for it? I assume there is a reason in each case.

Mr. J. F. Harmer, Assistant Director of Assessment Branch, Department of National Revenue: Mr. Chairman, would you like me to enlarge on these explanatory notes? They are very complete.

The CHAIRMAN: We can read the explanatory notes; I would rather you would just tell us in a few words what is the purpose of it. The first two sections may seem a little easy but as we go along they become more complicated.

Mr. HARMER: Mr. Chairman, the first section is to bring into the income of the recipient payments made under an order of the Family Court, in the same manner as the present law provides for bringing alimony payments into income in the hands of the recipient. It is also by a later clause made deductible in the hands of the payer.

Senator BRUNT: Up to the present time have payments made pursuant to an order of the Family Court not been taken into account in income tax returns?

The CHAIRMAN: They were paid out of the payer's income and he paid tax on it if he used income for that purpose.

Section 1 agreed to.

On section 2—R.C.M.P. pension or compensation.

Mr. HARMER: Section 2 exempts from tax certain pensions or compensation for injury, paid to members of the Royal Canadian Mounted Police, the same as in the case of civil servants.

Senator CROLL: Are they in a different position than the members of the civil service?

Mr. HARMER: Not now.

Senator CROLL: It had not been extended to them previously.

Mr. HARMER: It had not been done previously.

The CHAIRMAN: You will recall, Senator Croll, we had some discussion on the Estates Tax bill about the wording in the Income Tax Act on the computation of income and the exclusion of service pension or allowance.

Senator CROLL: Yes.

The CHAIRMAN: This is in addition to that section, is it not, Mr. Harmer?

Mr. HARMER: Yes, sir.

The CHAIRMAN: This is a further addition, adding the Royal Canadian Mounted Police to those already set out, including the Pension Act or the Civil War Pensions and Allowances Act, and section 5 of the Aeronautics Act. This provision would round it out; I think it gives as complete a recital as we have in the Estates Tax bill.

Section 2 agreed to.

On Section 3—re-payment of loan by shareholder.

Mr. HARMER: Subsection 1 of section 3 provides that a loan which was taxed as a dividend in the hands of the person who received it, when repaid to the corporation from whom he received it may be deducted in the year of repayment. Previously this was not permitted; he was taxed on it whether he repaid it or not.

The CHAIRMAN: Previously a loan to a shareholder, unless he repaid it within a year from the date of the fiscal period in which the loan was made, was taxable in the hands of that shareholder as a benefit conferred on him.

Mr. HARMER: That is right.

Senator BRUNT: And there is no limitation on it, even if he repays it 10 years hence?

Mr. HARMER: That is right.

The CHAIRMAN: Under the amendment, the loan still remains as income, but when the borrower repays it he is given a deduction.

Senator BRUNT: Mr. Harmer, did you refer to this as a dividend, or like a dividend?

Mr. HARMER: Yes.

Senator EULER: And not a loan?

Mr. HARMER: It is a loan, but deemed to be a dividend.

Senator BRUNT: If it was large enough, would it carry surtax?

Mr. HARMER: Yes. And also, it used to carry the dividend tax credit of 20 per cent, but by another section of this bill, that is removed. It is no longer subject to that tax credit as in the case of a dividend.

Senator BAIRD: I don't quite follow this. For instance, if I borrow money from a private company, and I pay it back—

Senator BRUNT: When?

Senator BAIRD: Within a year . . .

Mr. HARMER: If it is paid back within a year it never would be considered as income, but if, under the present act, it had not been paid back for more than a year it would be considered as income. Under this amendment you may deduct the repayment from your income in the year in which it is repaid.

Senator EULER: If you paid a tax on it as income, and later repaid the loan, you would get no allowance for the repayment?

Mr. HARMER: Not previously.

The CHAIRMAN: You get it indirectly now by way of a deduction from income in the year in which you repay the loan.

Mr. HARMER: Yes.

The CHAIRMAN: In other words, you must make sure that you have taxable income from other sources in the year in which you repay the loan?

Senator BURCHILL: Does that cover loans to shareholders?

The CHAIRMAN: The ordinary loans.

Now, subsection 2 of section 3 of the bill.

Mr. HARMER: Presently a contributor to a pension plan can contribute up to $1,500 in respect of his current earnings, but he can't increase his contribution in respect of past earnings, if he was a contributor in those past years. This allows him to aggregate his current contribution, and his contribution in respect of the past, and he may make a maximum contribution of $1,500 against both of those items.

The CHAIRMAN: The state of the law without this bill is that if a pension plan was put in and on employees is forced to embark upon that plan, he could make contributions to past service at that time, could he not.

Mr. HARMER: If he had not contributed previously.

The CHAIRMAN: At the beginning of the plan he could make a contribution for past services for the period in which he worked but there was no plan, and he could also make current contributions towards the plan.

Mr. HARMER: Yes.

Senator HAYDEN: This permits him while the plan is going on to make current payments to apply, and some payments on account of past service for a period prior to the year in which he is making the current payments.

Mr. HARMER: Yes.

The CHAIRMAN: But it is limited to $1,500 in each year.

Mr. HARMER: Yes.

Senator LEONARD: Does that mean a possibility of total contributions of $4,500, made up of $1,500 of current service, $1,500 for past service before the plan was put into effect, and $1,500 for past service while the plan was in effect when he was not a contributor?

Mr. HARMER: This $1,500 covers both current and past, while he was a contributor.

Senator CROLL: It is the sum total, $1,500.

Senator POULIOT: Mr. Chairman, would it be possible to know how much the department expects to get from this legislation?

The CHAIRMAN: I think we can get you the answer.

Dr. EATON: As I recall it, the minister estimated the long balance from this bill as a loss of about $4 million. Mainly that would come from the moving up of the percentage which corporations might give by way of charitable contributions. In the past they were only able to give up to 5 per cent of their income, without deduction. That has now been moved up to 10 per cent of their income. That, I think, will account for the bulk of the loss of revenue. The other item of significance was the broadening out of the medical expenses whereby in future they might claim expenditure on drugs, in addition to hospital bills and bills of the doctor. Those, I think, were the two main revenue-losing items. Most of these we are talking about are relatively insignificant from a revenue point of view.

The CHAIRMAN: Are there any revenue-gaining items?

Dr. EATON: I can remember one, but it does not affect Canadians; it affects non-resident-owned investment corporations. That, offhand, sir, is the only one I can think of as a revenue-producing or revenue-gaining provision.

On subsection 3:

Mr. HARMER: This one allows the payor to deduct a payment made by reason of an order of a family court.

The CHAIRMAN: This matches up section 1?

Mr. HARMER: Yes.

On subsection 4:

Mr. HARMER: That merely adds estate taxes to the section which permits interest to be deducted in computing income for income tax purposes.

The CHAIRMAN: So that if you pay interest in relation to the estate tax you may owe, it is a deductible item?

Mr. HARMER: That is right.

On subsection 5:

The CHAIRMAN: That is merely the application of these subsections to the years they come in force.

Section 3 agreed to.

On Section 4—Application of Section 12 (1) (c):

Mr. HARMER: Section 4 permits a holding company to have part of its investment in the subsidiaries' bonds and debentures. Previously it had to own all shares in order to qualify for this deduction. Now it can own bonds and debentures or mortgages of subsidiaries and still qualify for this exemption.

The CHAIRMAN: Yes, because in the ordinary way income passing from a subsidiary to a parent company by way of dividend would pass nontaxable. This provides that even in those circumstances the holding company may receive interest from the bonds of the subsidiary.

Mr. HARMER: Well, no. You will remember, sir, that expenses incurred to earn exempt income, such as these dividends from company to company, are ordinarily disallowed but in this one case they are allowable provided the company that incurs them meets these conditions. Previously the conditions were that it must hold shares of the subsidiary and now it is permitted to hold bonds and debentures as well as shares.

Senator ISNOR: Could you give us an illustration of that?

The CHAIRMAN: An example?

Senator ISNOR: Yes.

Mr. HARMER: Ordinarily, Senator Isnor, a company may borrow money and use that borrowed money to buy shares in another company. The dividends it gets from those shares are not taxable in its hands. Therefore the ordinary rule is that the interest it pays out to borrow the money cannot be deductible. In the case of this kind of a company whose only income is from this source, and who may have several subsidiaries, and it either borrows money or pays expenses or registrar's fees and transfer fees and things like that, it may deduct these items notwithstanding the fact that the dividends it receives are not taxable.

Hon. SENATORS: Agreed.

The CHAIRMAN: This may or may not as I see it, be of much importance. If the holding company, the owner of the subsidiary, is strictly a holding company, and therefore the only source of its income would be the income

received from the subsidiary, that would be non-taxable. The parent company would have to be engaged in some other operations and have some income which might otherwise be taxable so as to get some benefit from this section. So whether it covers a large area or not is difficult to say at the moment. I wouldn't think it would affect the revenues very much. It is really tying up these things. Section 4(2) provides for the date this subsection goes into force.

Section 4 agreed to.

On Section 5:

The CHAIRMAN: This is hobby farming.

Mr. HARMER: I think the purpose of this is to take out of the present rule, which disallows the losses of hobby farmers, those small cases up to $2,500 where there has always been a long, drawn-out argument as to whether the man really is a hobby farmer or he just happens to be losing money temporarily. This is designed to allow him up to $2,500 regardless of the circumstances. Over that he gets half of the excess but the maximum is still $5,000 as it is today. So it cuts out the smaller cases and leaves the bigger ones the same.

Senator BRUNT: Do you have two classes of farmers: dirt farmers and hobby farmers?

Mr. HARMER: We have at least those two classes.

Senator MACDONALD: Small hobby farmers and big hobby farmers.

The CHAIRMAN: I notice in subsection 3 you are writing a new definition of farming losses. Isn't that right?

Mr. HARMER: That's right. We are including in the farming loss, depreciation or capital cost allowance.

Senator BRUNT: Has the hobby farmer an option as to whether he will take the depreciation or capital cost?

The CHAIRMAN: It is the same thing. Capital cost allowance?

Mr. HARMER: Any farmer has the option of availing himself of capital cost allowance either on the reducing balance basis or on the straight line basis. They are both capital cost allowances for our purposes.

Section agreed to.

On Section 6.

The CHAIRMAN: Section 6 is simply the repeal of the section that dealt with accounting method.

Mr. HARMER: Yes, Mr. Chairman. The Department of Justice told us that did not mean anything, and there have been several complaints about it, so it was decided, being meaningless, we would take it out.

The CHAIRMAN: Well, the effect of repealing it is to put the Minister in the position where he can challenge at any time any accounting method that is being used; is that not right?

Mr. HARMER: We think he was always in that position, sir, but there had been some arguments about that. Previously the section provided that he could not change unless he had the concurrence of the Minister, and the problem always was has the Minister concurred in the method, and now it is just left to whatever method most closely reflects his actual income regardless of whether it is one that has been concurred in or not.

The CHAIRMAN: I can see problems possibly developing there unless that were done. If the Minister assesses the assessment it might be regarded as adopting the accounting practice of the return. If an assessment is going to be

opened years later because it was suggested that was not a proper accounting method I can see lots of problems over this.

Mr. HARMER: There can be, and I am afraid there may be.

The CHAIRMAN: I would think so, because it seems to me that if the Minister makes an assessment accepting the method of return he might have problems even though he has the right to re-assess.

Section 6 agreed to.

On Section 7—Election.

Mr. HARMER: Section 7 is one of those sections that affects people who become non-resident. Under the present law either a partnership which winds up because one of the partners retires, or a sole proprietorship which ceases business because the business is sold, in order to avoid having two years income in one, may elect to have the fiscal year ending with the date of retirement of the partner or sale of the business, end in the next following year. The difficulty with that was that we had an odd instance where some one who so elected moved out of the country before the next year and we couldn't catch up with him. This is designed to stop that happening by saying he cannot elect if he does that.

The CHAIRMAN: Well, he cannot elect unless he is a resident at the time he elects.

Mr. HARMER: No, he has to be a resident at the time the fiscal period would have ended by this election. If he elects that it ends in 1959 he has to be here and resident in 1959 to make that election valid.

The CHAIRMAN: But let us assume that he isn't.

Mr. HARMER: Then the election is invalid and there are problems of collections involved, but at least you have a valid assessment.

The CHAIRMAN: That is right; it is not a solution but it does put some restraint on the indiscriminate exercise of this right of election.

Senator ISNOR: May I ask this question under this section? In changing over form the business of an individual to that of an incorporated company, does he make his return for that period at the end of 12 months or 18 months?

Mr. HARMER: I do not know that I understand all the facts of your question, Senator Isnor. You say this man started on January 1st?

Senator ISNOR: His year has always been from January 1 to December 31, but he decides to incorporate his company in June and therefore he is carrying on for six months as an individual and the following six, twelve or eighteen months, as the case may be, he is carrying on as an incorporated company. When does he make his return?

Mr. HARMER: As an individual he would have to include in his return for the year of change his six months profits as an individual plus whatever he got from the corporation in the last six months of the year by way of dividends, interest or salary. And then the corporation would choose its own fiscal period and it may elect to take a December year end, in which case it would file only for the last six months of this year, or the corporation may choose to elect a June 30 year end and it would make its return for the year ending on June 30 of the next year.

Senator ISNOR: He files for the end of the twelve months his personal return?

Mr. HARMER: All I can do, Senator Isnor, is to repeat what I have already said, that he files for the year of change for the full twelve months and he files it in April of the next year and in it he reports six months business profits as an individual plus six months salary, dividend or interest or whatever else he gets from the corporation, and the corporation files depending on what year end it elects six months after the end of that year.

Senator ISNOR: My second question is—and I want to get this clear because I think there is a point at stake—that a newly incorporated company can take their fiscal year in future from January to December is that right?

Mr. HARMER: Yes.

Senator ISNOR: And all that is necessary is for the corporation to file from July 1 to December 31 of that particular year?

Mr. HARMER: Yes.

The CHAIRMAN: I notice that this section is applicable to elections made after 1957. Is that to cover a particular case?

Mr. HARMER: No, it is another way of saying 1958.

The CHAIRMAN: Some of the sections say that it is applicable to 1957 and subsequent years and in this section you say it is made applicable after 1957. The draftsman was showing a flare for saying the same thing in two different ways, is that it?

Mr. HARMER: Yes, Mr. Chairman.

Section 7 agreed to.

The CHAIRMAN: We now come to section 8, and this section runs through four or five pages of the bill. It deals with lease-option and hire-purchase agreements. Would you care to state as summarily as you can the effect of these sections? Would you state what the present situation is?

Mr. HARMER: I wish I could, Mr. Chairman, but unfortunately I just got back from Montreal this afternoon and I have not my marked copy of the bill and this is not a section which you can summarize very readily. Mr. Irwin, though has a statement here which you might find enlightening.

The CHAIRMAN: I will read this, and this will start the discussion.

This clause provides for a complete revision of section 18, which deals with lease-option or hire-purchase agreements. Under some agreements a lessee is required to pay substantial amounts designated as rental payments and is given an option to purchase the property for a nominal sum at the end of the period. It is frequently obvious that the so-called rental payments are really instalments of the purchase price. Section 18 provides that these agreements are to be regarded as purchase agreements. On some points, the present legislation is very obscure, if not ambiguous. The proposed new section is somewhat longer because it spels out in detail what is to be done in a variety of circumstances. I have been assured by the officials that these elaborations do not change the accepted interpretations of the present law and I believe that those taxpayers who are affected by the section will be pleased to have the rules specified more clearly.

The proposed revision does include two substantive changes. It contains special provisions for cases where the lessor and lessee are not dealing at arm's length. These bring the section in line with the other rules in the act covering other purchases and sales that are not at arm's length and block a possible loophole. The second, and more significant change is a provision that section 18 will not apply at all in many cases. The specific provisions in this regard contained in the proposed new subsection (4), should remove from the application of this section all those cases where it is reasonably clear that the rent being paid is really rent and no part of it is on account of the purchase price.

Senator HAIG: Mr. Chairman, when did this section 18 come into the act?

Mr. HARMER: It has been in quite a while.

Senator HAIG: But how long ago, can you tell me? I remember that in one case I beat the act and an amendment was brought in at the next session to catch me, so I know what the act does exactly.

Mr. HARMER: It was in the 1948 Act.

Senator HAIG: It was before that, and then you brought in an amendment right after.

The CHAIRMAN: There was an amendment made in 1954 I know.

Senator HAIG: Tax evasion as envisaged in this section mostly occurs in connection with road-building equipment. This equipment is very expensive, each piece running up to $60,000 or $70,000.

The CHAIRMAN: I think the really important part of these four or five pages you will find in subsection 4 which is at the bottom of page 6 and goes over to page 7. It really tells us under what circumstances purchases of this type do not apply and when the amount is treated as rent and when it is treated as purchase price. You will find that if five years after the contract or arrangement was entered into the cost payable on the exercise of the option is not equal to 10 per cent of the fair market value of the property at the time the agreement was made, the contract will become a purchase, but if the consideration that is payable then is 100 per cent of the fair market value of the property at the time the arrangement was originally entered into, then such option and hire-purchase provisions do not apply. The rent is rent, and the purchase price is purchase price. Is that right Mr. Harmer?

Mr. HARMER: That is right.

Senator HAIG: But that should not be the value of the equipment after it has been used for three or four years, because the rent pays for that depreciation.

The CHAIRMAN: If, say, in four years time a condition occurs as a result of which the option that is in that sales arrangement—the option to buy—is exercised, in those four years the man has paid sums of money which he chooses to call rent; and, if the purchase price becomes payable, and that purchase price is equal to 100 per cent of what the fair market value was of the property at the time the original agreement was entered into, then I say the rent that is paid is treated as rent. Otherwise even though you call it rent and pay it, it is treated on account of the purchase price, and the person who pays it does not get any deduction as an expense of doing business.

Mr. HARMER: Only by way of capital cost allowance.

Senator HAIG: And the officials decide whether payments equal that or not?

The CHAIRMAN: No. The department has to decide if it is within, say, five years of the date of the original lease-option agreement, whether or not, when that option is exercised, the cost payable on the exercise of the option is equal to 100 per cent of the fair market value of the property at the time the agreement was made.

Mr. HARMER: We don't wait until five years have expired; it is decided by what is in the contact.

Senator HAIG: Then you do not give him credit for any principal he has paid in addition to his rental payments? Supposing the interest on the money was $4,000 a year, and, as frequently happens, the buyer pays as much as $8,000 a year, you could not give him a credit for that $4,000 of principal?

Mr. HARMER: No, sir.

Senator HAIG: Never at all?

Mr. HARMER: I don't know whether I follow you, senator.

Senator HAIG: Supposing a man buys an excavating machine for doing road work at a cost of $70,000, and he pays on it so much a year interest and so much principal.

Mr. HARMER: Does he buy it or lease it? If he buys it, this section has no application at all.

The CHAIRMAN: He would have to lease it with the option to buy, to have this section apply; if he buys it, there is no problem.

Senator HAIG: But the fellows who sell these machines won't sell them that way.

The CHAIRMAN: That is why we have lease-option agreements.

Senator HAIG: I act for these vendors sometimes, and I know they won't sell these machines on the ordinary agreement; if there is default they don't want to be put to the trouble of taking proceedings. In this way, if a man fails to meet his payment due on December 1st, they can come in and take the machine without any proceedings.

Senator BRUNT: You can do that in Ontario with the Conditional Sales Agreement.

The CHAIRMAN: Let me put the question this way: Let us say the purchase price of an excavating machine is $70,000—that is the fair market value of it at the same time the lease-option agreement is made—there is an annual payment in the amount of, say, $5,000 a year. Then in three years the man who acquired the machine under that agreement decided to exercise the option and buy it for $70,000.

Now, as I understood you, you tell me that in the first year when this becomes exposed to your gaze, you would settle the question as to whether $70,000 was a fair market value at that time, is that right?

Mr. HARMER: That is as I understand it.

The CHAIRMAN: Now do you permit the so-called rental payment to be treated in the period before the option is exercised?

Mr. HARMER: As expenses.

The CHAIRMAN: So, if he pays rent each year, and the rent is not a credit on account of the purchase price, and the purchase price when he exercised the option represents 100 per cent of the fair market value of the machine, then section 18 would not apply.

Mr. HARMER: That is right.

Senator HAIG: Let me state my case. The machine costs $70,000; the interest rate is 6 per cent, making $4,200 a year. The purchaser pays $9,200 a year, because that is the only way the vendor will sell it to him. As I said, they sell it on an option agreement because they want to be able to take it back if the buyer fails. That is where the trouble lies—they won't give him credit for that $5,000.

You should state what the interest should be, and then tax him only on the balance when he is short. That is my contention, and always has been.

The CHAIRMAN: What we are trying to arrive at here tonight is what the section is intended to do. Whether it does that or does not, is a question that can be settled sometime in the future. The purchaser can't have those so-called rental payments allowed as a deduction in the year in which he pays them, if they are going to be applied on account of the purchase price, is that right?

Mr. HARMER: That is right.

The CHAIRMAN: He can't have it both ways.

Senator HAIG: You missed my point, Mr. Chairman. The fellows who sell these machines want to get an extra payment of $5,000 a year, and that is a genuine payment; it cuts down the amount owing on the agreement.

The CHAIRMAN: The only answer in section 18 is, if you are going to make a payment on account of the purchase price it will not be treated for income tax purposes as rent.

Senator BRUNT: That is right.

Senator HAIG: But he does not take up the option; they won't let him take up the option.

The CHAIRMAN: What I am concerned about is getting a clear statement as to what is the intended effect of the amendment.

Senator LEONARD: Senator Haig's case, as I understand it, would be treated as a straight purchase and sale agreement, for income tax purposes, is that not right?

Senator HAIG: That is what I want.

Senator LEONARD: In other words, the option for purchase would be for less than $70,000 within five years, because the purchaser would be entitled to credit for some of the amounts which he had paid in the intervening years; therefore, that would not be a true rental agreement, but would be a purchase and sales agreement.

Mr. HARMER: I believe so, senator.

The CHAIRMAN: Dr. Eaton, would you care to express your opinion—?

Dr. EATON: Please don't ask me any questions about this.

Mr. SHEPPARD: That statement is correct.

The CHAIRMAN: Mr. Sheppard says that it is correct, for what it is worth—

Senator BRUNT: I don't like that, "for what it is worth"—I think it is worth a lot. Let us pass it.

The CHAIRMAN: Any further questions. I don't want to pass it until every senator has a full explanation.

Section 8 agreed to.

On section 9—alimony and maintenance cases.

The CHAIRMAN: This section would adjust the $250 income as between husband and wife.

Senator BRUNT: Could we have an explanation of what the section does?

Mr. HARMER: At present the law provides that the moment the income of the wife exceeds $1,000, even by as much as $1 a year, her husband's exemption immediately drops from $1,250 to $1,000. This section is designed to make them peter out at the same point; that is, for every dollar she earns over $1,000 up to $1,250, his exemption comes down by the same amount until when her income reaches $1,250 that is the point at which his exemption reaches the $1,000.

Senator BURCHILL: That is a fair proposal.

Mr. HARMER: I think so.

The CHAIRMAN: At the present time if the wife has income of $1 more than $1,000 then the husband becomes taxable—

Mr. HARMER: He becomes treated as a single person.

The CHAIRMAN: It is a beneficial section.

Subsection 2 of section 9 belongs to subsection 3 of section 3.

Mr. HARMER: Yes, this is a cross-reference. It denies the payer of these amounts ordered by the Family Court, the right to claim the persons in respect of whom he is paying those amounts as dependants, as well as claiming the payments as deductions from income.

The CHAIRMAN: Of course if the husband is not going to have the payments treated as income, then he will not be allowed tax deductions for the children.

Mr. HARMER: That is right.

Section 9 agreed to.

On section 10.

The CHAIRMAN: This is an application section. What is it directed to, Mr. Harmer.

Mr. HARMER: As I understand it, every year certain amounts are voted for payments to immigrants, which are somewhat equivalent to family allowances, but are called family assistance. When those payments are made to an immigrant, for income tax purposes, when he claims dependents in respect of whom he has received such payments, those dependents are treated in exactly the same way as if the immigrant had received family allowances; in other words, he gets the lower deduction, as he would if he had collected the family allowance.

Section 10 agreed to.

On section 11—charitable donations.

The CHAIRMAN: Section 11 steps up from 5 to 10 per cent the deductible contributions for charitable purposes by corporations.

Mr. HARMER: That is right.

Senator CROLL: Dr. Eaton said that would likely reduce our overall take, —the increase from 5 to 10 per cent. But the record is that contributions by corporations over the years have been on an average, I believe, 1.5 per cent.

Dr. EATON: About one per cent. It is even worse!

Senator CROLL: I thought it was one per cent, but it seemed so little I was afraid to mention it. What makes you think that they will give more because they are allowed to give up to 10 per cent?

The CHAIRMAN: The point is that some of the bigger corporations do give up to the present limit of 5 per cent.

Senator CROLL: You think they will give more?

Senator LEONARD: I think it will come from the generous corporations, not from those who are not giving anything.

Senator HAIG: International Nickel has been giving to the colleges much more than that. They started last year or the year before.

The CHAIRMAN: Is that correct, Dr. Eaton?

Dr. EATON: I do not know of any particular case, but I know there are a large number who go up to the limit; and year after year there have been quite a number of requests for more leniency in this direction, and for carry-forwards. Last year we gave them the carry-forward. So, in effect, if they give too much one year they can carry it forward to the succeeding year.

Senator HAIG: What do you give to individuals?

Dr. EATON: Ten per cent.

Senator HAIG: Why don't you give them 15?

Dr. EATON: I have no answer for that.

The CHAIRMAN: That is exactly the answer I expected.

Subsection 2 on page 8 implements some of the budget resolutions. Is that right?

Mr. HARMER: Regarding medical expenses.

Senator BRUNT: The first subclause reads: "For transportation by ambulance to and from a public or licensed private hospital for the taxpayer, his spouse or any such dependant". Why do you put "ambulance" in? A poor steel worker takes his wife down to the hospital in a taxi to have a baby: you won't allow him anything.

Mr. HARMER: This is something somebody in the Department of Finance will have to answer, not me.

Senator CROLL: The answer is very good. An ambulance is an ambulance.

Senator BRUNT: All right. What about the fellow in West Toronto who wants to get downtown in a hurry, and he gets an ambulance; all he has to do is to drive to St. Michael's Hospital, and it is allowed to him.

Dr. EATON: I think the point is that taxis, streetcars and what have you are rather hard to identify by way of administration, whereas an ambulance is an ambulance and is pretty identifiable

Senator CROLL: It is different in the large populated areas. I realize your administrative problem.

The CHAIRMAN: Except there is this obviousness about the situation, that if a man lives in New Toronto and his wife has a baby in St. Michael's Hospital in Toronto you have got to figure out some method of transportation to get her from her home to St. Michael's Hospital. So all the factors are determinable.

Senator MACDONALD: He can take a streetcar!

The CHAIRMAN: Oh, no.

Senator LEONARD: This is more applicable where people are some distance from a hospital, and the ambulance fee may be some size.

Dr. EATON: They send them up the Gatineau here. It is $5.00; it is not too much.

Senator BRUNT: A man is in Cochrane and takes an ambulance to Toronto, it may represent $150 and you will allow it him, but if his wife is at Kapuskasing and he flies down, there is no allowance.

Dr. EATON: Not by ordinary plane.

Senator BRUNT: It would have to be an ambulance plane. Don't you think the words "as prescribed by such medical practitioner", should be added? You have got it in all the other subsections.

Dr. EATON: He might not know beforehand he had to get her to the hospital.

Senator BRUNT: It does not have to be done before.

Dr. EATON: I am a little out of my depth on these administrative matters.

The CHAIRMAN: It seems to me the approach to this is, these are beneficial, and we should accept them. If there are any extensions that we think are still to come I think it is all right to raise them; it will be a matter of record; and I am sure Senator Brunt will be in a position to bring them to the attention of those who should hear them.

Senator HAIG: All medical expenses should be exempt.

The CHAIRMAN: Well, we are working in that direction.

Senator HAIG: Pretty slowly.

The CHAIRMAN: I know that, but—

Section 11 agreed to.

On Section 12: *Application of Section 27 (1) (e).*

Mr. HARMER: In order to explain this I should go back to what the law was before this amendment, which is that a business, either incorporated or not incorporated, may carry a loss back one year and forward five years, but that loss may only be deducted from income from the same business in one of these other years. The purpose of this amendment is to make the loss deductible against income from any business, not necessarily the same one in which the loss was incurred.

The CHAIRMAN: You have got to have a little bit of a check-rein on it, have you not?

Mr. HARMER: Yes. The next section is designed to prevent this being taken advantage of by people who buy up loss companies for the purpose of carrying forward that loss.

The CHAIRMAN: I am sure that all lawyers on the committee know from experience that premiums are sometimes paid for taking over a company which has a large deficit. People seem to feel that some benefit could be obtained from it. Now, of course, you are blocking the operation of these instances of loss carry-forward and back, so that you cannot use a deficit company to take advantage of such an extension of the law. That is right, is it not?

Mr. HARMER: That is right.

On paragraphs 5 and 6, subsection 2:

Mr. HARMER: This is designed to deny the extension to the hobby farmer, because if he cannot get his farm loss in the year it is incurred, it is obviously unfair to allow it in other years.

Senator BRUNT: I don't like that word "obvious".

Mr. HARMER: Obvious to us.

The CHAIRMAN: You have written a special formula for so-called hobby farming, anyway.

Mr. HARMER: That is right.

Section 12 agreed to.

On Section 13—Dividends received by corporations.

The CHAIRMAN: What have you to say about that, M. Harmer?

Mr. HARMER: Well, as the explanatory note says, it just changes the words "wholly owned" to "controlled". This is a section in which designated surplus is involved, and the subsection which is being amended is one where the designated surplus provisions do not apply. This is widening that exemption slightly by making it applicable where the corporations referred to were controlled and not wholly owned.

The CHAIRMAN: Not wholly owned?

Mr. HARMER: Yes.

The CHAIRMAN: It is highly technical, but it is relieving.

Next is subsection (2).

Mr. HARMER: That is the same idea. It deals with the words "after 1954", and nobody seems to know how they got in there in the first place. But they did operate to deny the benefit of the section to persons who otherwise would benefit, and there didn't seem to be any object in the words "after 1954" being in there.

The CHAIRMAN: Your designated provisions came in in May, 1950, I believe?

Mr. HARMER: I believe so.

Hon. SENATORS: Carried.

The CHAIRMAN: Next is subsection (3). I understand that is just the application date.

Mr. HARMER: That's right.

Section 13 agreed to.

On Section 14—Investment Income Defined.

Mr. HARMER: Section 14 is a refining of the definition of investment income to include something that wasn't mentioned before as a deduction, gifts made to the Crown, and to correct an oversight last year when the $100 standard

deduction was provided. There was no mention made of it in the definition of investment income, and it is being corrected here.

The CHAIRMAN: I assume as a matter of practice in the administration of the act you have been assessing on the basis of what you are now making the law?

Mr. HARMER: That is right.

The CHAIRMAN: In other words, you have been allowing this.

Senator CROLL: What do you mean by a gift to the Crown? Give me an example, will you please?

Mr. HARMER: As the Minister said in the house, it could be gifts of memorial parks, and so on. I can also think of gifts of paintings to the National Art Gallery. I suppose there might be some historical sites or things of that kind.

Hon. SENATORS: Carried.

The CHAIRMAN: Next is subsection (2) on page 10 of the bill.

Mr. HARMER: This is also a change in the definition of investment income and it removes alimony from the category of investment income.

Senator BRUNT: That ought to make a lot of people happy. Couldn't it be made retroactive?

The CHAIRMAN: Is there any explanation required on this subsection?

Hon. SENATORS: No. Carried.

The CHAIRMAN: The next is subsection (3).

Mr. HARMER: This one also has to do with investment income surtax and again it is merely to bring the law into line with the practice so that rental losses will be deducted from earned income rather than investment income.

The CHAIRMAN: Last year we took rental income out of the category of being subject to surtax as investment income.

Mr. HARMER: That is right.

The CHAIRMAN: So now you are saying if these are rental losses they will be charged against earned income and not rental income?

Mr. HARMER: That is right.

Section 14 agreed to.

On Section 15:

Mr. HARMER: This increases the tax credit in respect to individuals resident or carrying on business or employed in Quebec from 10 to 13 per cent.

The CHAIRMAN: Any question on this?

Section 15 agreed to.

On Section 16:

Mr. HARMER: This is the section I referred to earlier. It is tied up with the earlier amendment on loans to shareholders by corporations. This section takes them out of the category of dividends entitled to the dividend tax credit.

Section 16 agreed to.

On Section 17:

Mr. HARMER: This is to correct an oversight in the amendments which, if it were not corrected, would allow corporations who carried on business in Ontario to get a tax credit in respect of the 1956 portion of their 1957 fiscal period when they, in fact, paid no Ontario tax on that income.

The CHAIRMAN: That would be for companies whose fiscal year ended sometime during the year 1957, other than the calendar year?

Mr. HARMER: That is right.

Section 17 agreed to.

On Section 18:

The CHAIRMAN: This is a method of determining foreign tax credits, isn't that right?

Mr. HARMER: It is a change in the formula for computing foreign tax credits. It is beneficial.

The CHAIRMAN: The reason for it has something to do with the provincial tax, has it not?

Mr. HARMER: Yes. It is a little involved and perhaps Dr. Eaton could explain it better than I could.

Dr. EATON: Perhaps I can explain it in this way. This is the situation before the amendment. Let us take the case of a bank which has income from the United States. We tax that foreign income at 47 per cent, and the way the law stood they never could get against their Canadian tax the full credit for that 47 per cent because their effective rate in Canada was something less than 40 per cent on the average because we gave tax credits in respect of income earned in Ontario and Quebec. So the effective rate of tax on all income having regard to the abatement in Ontario and Quebec was something less than 47 per cent overall. This allows them to get the full credit of 47 per cent on that income, which we tax at 47 per cent, even though the effective rate on all the income is less than 47 per cent because of the abatement in Ontario and Quebec.

Hon. SENATORS: Carried.

The CHAIRMAN: That brings us down to subparagraphs (2) and (3) on page 12 of the bill. I understand these are consequential?

Mr. HARMER: Yes.

Hon. SENATORS: Carried.

The CHAIRMAN: And I understand that subsections (4) and (5) on page 13 of the bill are also consequential.

Mr. HARMER: Yes.

Section 18 agreed to.

On Section 19:

The CHAIRMAN: Would you give us an explanation on this, Mr. Harmer?

Mr. HARMER: We as a department are unable to check every taxpayer's return every year and we had always thought that despite this fact we would one day catch up with someone who was under-valuing his inventory and we could correct it in the year we found the under-valuation, but we have been told on at least one occasion by the courts that if we corrected the closing inventory of one particular year, and the opening inventory of that year is not also corrected, we cannot make our assessment stick. We have to go back and value the opening inventory on the same basis as the closing one, and so on, back through all the preceding years as far back as we can go. This amendment is designed to allow us to make this correction when we find this under-valuation in the year in which we find it; but it gives the taxpayer the same right as he has in respect of recapture of capital cost allowances to have the extra tax applicable to that under-valuation taxed for the preceding five years at the rates in effect for those five years.

The CHAIRMAN: Are you attempting in this section to deprive the taxpayer of the right of contesting a re-assessment that would be based on a change in the value of the closing inventory in a year, to prevent him from raising the

issue on an appeal that that method if applied to the opening inventory would produce this different result—and I claim it should apply. Isn't that the effect?

Mr. HARMER: I think that is the effect.

The CHAIRMAN: That is the intended effect?

Senator CROLL: Would you repeat your question, Mr. Chairman?

The CHAIRMAN: This section purports to give the Minister the power to change the valuation, the method of valuation of inventory, so as to establish a correct value of the inventory at the end of the year. Now, the valuation of an inventory affects the amount of profit.

Mr. HARMER: That is right.

The CHAIRMAN: Now, Mr. Harmer says that this section if passed would enable them to make that change in the value of the closing inventory without going back to the beginning of the year and applying the same method to change the opening inventory value.

Senator CROLL: What the section is doing is trying to overcome a decision of the court?

Mr. HARMER: That is right.

Senator CROLL: That is the purpose of it.

The CHAIRMAN: But the question I put was that even though it is intended to create a more tenable position for the Minister in valuation, is it intended that this section would prevent the taxpayer in appealing on re-assessment?

Senator BRUNT: To apply the same method to the opening?

The CHAIRMAN: Yes, to apply the same method to the opening valuation.

Mr. HARMER: Well, I don't know that you can say, sir, it is intended that he cannot argue about it; the same arguments hold at the end of the year as at the beginning. It prevents or at least makes unnecessary the re-opening of a number of prior years during which the same arguments would have come up and in respect of which heavy interest charges might arise if they were re-opened, but the taxpayer is still able to argue whether the method of valuation is right or wrong.

Senator BRUNT: I think all we are concerned with is whether the same method that you have adopted for the year end is going to be available for the taxpayer to apply to his opening inventory.

Mr. HARMER: The same year?

Senator BRUNT: The same year; it has to be the same year.

Mr. HARMER: No.

Senator BRUNT: It is not?

Mr. HARMER: No, the theory being that he has understated his income in some prior year and we haven't been able to catch up with it till this year.

Senator LEONARD: If you make the revenue department use the same method at the end of the year as at the beginning, then you make their re-assessment nugatory?

Mr. HARMER: That is right.

The CHAIRMAN: But there is a fallacy in this. That is on the assumption that this undervaluation has been going on for a number of years and you finally catch up with it in one year?

Mr. HARMER: Right.

The CHAIRMAN: But let us assume that the year in which you check is the earliest year in which it occurs. Now, you are going to visit the same penalty on

that man as the man who has been juggling all through the years, and this section is to catch up with this fellow who has been doing it as a regular practice?

Mr. HARMER: Yes.

The CHAIRMAN: But you are going to catch the fellow who does it just once?

Mr. HARMER: We can always catch him, and still can, and since he made this understatement in one year it is corrected all in one year.

The CHAIRMAN: I was looking at the wording of the section, which says:

> "Where the property described in the inventory of a business at the commencement of a taxation year has, according to the method adopted by the taxpayer for computing income from the business for that year, not been valued as required by section 14,..."

In other words, what you are saying is that you certainly are closing the door there because you are assuming as a matter of law that the valuation for the commencement of a year is a valuation in accordance with the act?

Mr. HARMER: That is right.

The CHAIRMAN: So you are closing the door on the taxpayer to be able to raise the question if there is a re-assessment, and it gives you the right to change the method of valuing his closing inventory and affirm as a matter of law that his opening inventory has been properly valued?

Mr. HARMER: That is right.

The CHAIRMAN: And then he gets whatever tax is imposed, whatever extra burden is imposed upon him, and he cannot wiggle under that?

Mr. HARMER: We hope not.

Senator EULER: Let us say he has undervalued his inventory by say $50,000; that would increase his profit by $50,000. Would that be payable on the basis of the one year, or could you spread it over five years?

Mr. HARMER: You can figure the extra tax by reference to the preceding five years but it is all payable at the end of the year.

Senator EULER: Well, they tax it immediately on the basis of the extra $50,000.

The CHAIRMAN: It is taxed in the one year.

Senator BURCHILL: But if he has undervalued, would not that $50,000 show up in the profits of the succeeding year?

Mr. HARMER: It would if that inventory was disposed of in the succeeding year, but in the usual course of events it at least stays level, and sometimes goes up, so that there is an increasing amount each year which never gets reported unless the taxpayer goes out of business and completely liquidates his inventory.

Senator ISNOR: I cannot follow this method of change by the Minister. Supposing a merchant has an inventory starting in 1955; that is his opening figure. Then he buys a certain amount of merchandise during that year, and that is added to what he has. If he does not sell a dollar's worth, of course, he would have the two together; but if he does, therefore that has deducted one from the other and the amount he should have on hand is left. Now, if he wants to take his retail price, we will say with a 40 per cent or a 33⅓ per cent mark-up, and carries it there from year to year, you cannot change that system into a cost-price system without making the merchant suffer one way or another by an increase or otherwise. But on the other hand if he sticks to that one system, although it might vary a little, there will be an adjustment of

stock for that year; it might be for $1500 or $2500, and the income tax people at the end of the year will get it, if the merchant keeps proper books, which I think the average merchant does.

The CHAIRMAN: Well, there might be three inventories, namely, raw material, work in process, and finished goods.

Senator LEONARD: Supposing one year he changed the value and cut it in half?

Senator BRUNT: Supposing he does not put the true figure in and takes $25,000 off it?

Senator ISNOR: He cannot do so without it showing up in his statement, unless he juggles the whole statement right through.

Senator BRUNT: That does not say the corporation or the taxpayer is carrying a cushion of 25 per cent or 35 per cent in the inventory. Is that what it is aimed at?

The CHAIRMAN: It may be aimed at this type of goods. If I carried more work in process and less in finished goods I would have a lower inventory and yet I would have increased cost on account of carrying the finished goods.

Senator HAIG: He can take a larger discount than he took before.

The CHAIRMAN: If I had finished goods and treated any part of them as work in process they would stand at a lower figure but my expenses would be higher. Have you any particular illustration, example or exhibit, Mr. Harmer, that you might refer to as an illustration of the application of this?

Mr. HARMER: The ways of tax evaders are many, and besides those already mentioned there are numerous others. You can forget whole warehouses full of goods completely. People do not bring in their factory overhead when they are computing cost. In fact there are innumerable ways of undervaluing.

The CHAIRMAN: If I had a warehouse full of goods and if I did not include it in my closing inventory, the only place you are at a disadvantage is where I get the cost of acquiring that inventory into my costs of operation.

Senator HAIG: Suppose you take the case of a general store, selling clothes and all that kind of goods. I worked in a store for a number of years, and when I looked at a label I could tell at once that that was overalls, twelve pairs, and they cost us 85 cents a pair, but the owner of the store always said, "John, note the price and lower it by 10 per cent below what we paid for them". So, if we paid 85 cents, I was to show 75 cents. There was no income tax in those days—that was away back maybe before some of you fellows were born. The storekeeper did not want to show too big an inventory and all we had to do,—I knew and he knew—was to cut it down 10 per cent and there was no way of catching it.

Senator CROLL: That is not unreasonable; that is normal.

The CHAIRMAN: This section is not designed for that sort of thing.

Senator LEONARD: Does the department recognize the last-in first-out system of keeping inventories?

Mr. HARMER: No, sir.

Senator LEONARD: Then, if the company had been keeping a last-in first-out inventory and were required to change to first-in first-out this section would apply?

Mr. HARMER: That is right.

Senator LEONARD: Even though the company had been quite honestly carrying on an accepted practice of last-in first-out, you would require them to change over, and then under the court decision you mentioned they could then have applied the first-in first-out to their opening inventories and your

tax would have been just the same as if there had been no change in your system. This amendment now enables you to take the one on the basis of last-in first-out and change it, and the increase in the inventory is taxable in that year?

Mr. HARMER: That is right.

Senator LEONARD: Is that not the case to which you have reference?

Mr. HARMER: Yes, the Anaconda copper case which went to the Privy Council.

The CHAIRMAN: It is not a case that dealt with a fraudulent undervaluing?

Mr. HARMER: No.

The CHAIRMAN: We have been looking at this on the basis that some rogues have been operating in business and cheating the Treasury.

Senator BURCHILL: In valuing an ordinary merchandise inventory I was always under the impression that it was market value or cost, whichever was the lowest. Is that still correct?

Mr. HARMER: That is still the rule, Senator Burchill.

Senator CROLL: Do we follow the same principle as the United States does with respect to inventory for taxation purposes?

Mr. HARMER: I do not believe so.

Senator LEONARD: They allow the "lifo" system.

Senator MACDONALD: I think they allow an option there as between "lifo" and "fifo", do they not?

Mr. HARMER: I believe they do allow it in some cases, but I noticed in the report of a case the other day that a department store was denied the right to use it.

The CHAIRMAN: The only thing that seems to bother people about this is that we have been approaching it on the basis that there has been some scheming or conniving in connection with the inventory, but the main purpose of this is to avoid the results of a decision—

Mr. HARMER: No, no, Mr. Chairman, I would not agree with that, because if a company admitted that they were using "lifo" openly on their returns we would never have accepted that return; but if we found that they were using the "lifo" principle and did not disclose it on their return then what you say would be right. We would still in effect be correcting a difference in method, but I think it would have some element of avoidance in it because they were not honest enough to tell us what method they were using.

The CHAIRMAN: There is a difference between "lifo" and "fifo", and where you have two accounting methods that have sway, and they certainly have considerable sway in the United States, I do not think you can put that kind of tag on it.

Mr. SHEPPARD: There are very few companies that use the "lifo" principle. I do not really think this affects the lifo principle at all. It could be, as Mr. Harmer says, that some company could be using "lifo" and does not disclose it.

The CHAIRMAN: Did the decision which you referred to, the Anaconda decision I think it was, have the effect of interfering with you being able to tax a fellow who was rigging his inventory?

Mr. SHEPPARD: No, it had no bearing on that.

Mr. HARMER: That was not the decision which caused this.

The CHAIRMAN: I understood you to say earlier that this section was brought in because of that decision.

Mr. HARMER: No, not that decision; it was another one.

Section 19 agreed to.

On Section 20—Refunds.

The CHAIRMAN: This is a beneficial section. You can get a refund within four years if this becomes law, instead of two years.

Senator BRUNT: Let us pass it quickly.

The CHAIRMAN: It also provides for increasing the rate of interest that you get on overpayments from 2 per cent to 3 per cent.

Now we come to subsection (3) of section 20. This provides for an increase in the refund rate to 6 per cent if the overpayment is determined by the court.

Mr. HARMER: This amendment does not change the 6 per cent. All it does is say "6 per cent instead of 3 per cent", instead of "6% instead of 2 per cent."

The CHAIRMAN: Now we come to subsection 4 of section 20. This is just the application.

Senator CROLL: Has that not always been the case? I always assumed that to be the law.

The CHAIRMAN: That is right.

Senator CROLL: Why did they do it?

The CHAIRMAN: It was because they were steping up the rate from 2 to 3 per cent.

Senator CROLL: I am referring to section 21.

Section 20 agreed to.

The CHAIRMAN: Section 21 is correcting a decision of the Tax Appeal Board.

Mr. E. S. MACLATCHY: In a recent decision the Income Tax Appeal Board held that the taxpayer must have the notice of appeal in the hands of the board within 90 days. We felt that was never intended, and we previously considered that if it was marked within 90 days it would be on time. For this reason section 89 of the Act is being amended and the amendment to section 58(2) is made to provide the same rule for notices of objection. This section provides that a notice of objection is considered to be served on the date it is mailed, and thus overcomes the decision of the Income Tax Appeal Board.

The CHAIRMAN: As long as the notice is put in the mail it is effective from the date of mailing.

Section 21 agreed to.

On section 22.

The CHAIRMAN: Section 22 simply changes the name of the Income Tax Appeal Board to "Tax Appeal Board". That change, I take it, is brought about by the broadening of the powers under the Estate Tax bill.

Section 22 agreed to.

On section 23—municipal authorities.

Mr. HARMER: This amendment would add "in Canada" to section 62, which it is amending, which exempts a municipality from tax on any business operation it may have. We inadvertently said "any municipality"; and this is designed to make clear that it is only Canadian municipalities that get the exemption.

Section 23 agreed to.

On section 24—deductions not permitted.

Mr. HARMER: This denies to an estate or trust which is taxable as such, the $100 standard deduction in lieu of charitable donations and medical expenses, which the estate can't claim anyway. Previously an amendment was left out, and last year they were able to claim the $100.

The CHAIRMAN: Subsection 1, carried.

Subsection 2, non-resident beneficiary.

Mr. HARMER: This subsection affects a non-resident estate carrying on business in Canada or receiving rentals from property in Canada, and electing to file a return as though it was a resident of Canada. Any estate is allowed to deduct the amounts paid by it to beneficiaries, before computing its own income. We had a situation where a non-resident estate would file a Canadian return and claim a deduction for the amounts paid to beneficiaries who were not resident in Canada; thereby leaving the estate with no taxable income. We could not tax the non-resident beneficiary, because Part III of the act taxes only payments made to non-residents by residents of Canada. Here it was a payment going from a non-resident to a non-resident, and we ended up with no tax. This is designed to correct that situation.

The CHAIRMAN: Subsection 2, carried.

Subsection 3 is consequential.

Mr. HARMER: That is consequential on the previous subsection.

The CHAIRMAN: Subsection 4.

Mr. HARMER: This again is to bring the law pretty well in line with practice. When rental income was made not subject to surtax there was an agitation to have it recognized when it came to a beneficiary through a trust or estate; and there were no rules in the law as to how much of the estate's income should be considered as rental income. This provides the rules.

The CHAIRMAN: It provides for an allocation as between investment and rental income?

Mr. HARMER: Yes.

The CHAIRMAN: In the distribution.

Mr. HARMER: To the beneficiary.

Section 24 agreed to.

On section 25:

Mr. HARMER: This section relates to the earlier section about loans to shareholders from corporations. Here they are being treated as no longer subject to dividend tax credit.

The CHAIRMAN: With respect to the reference to section 81, which defines or sets out certain types of deemed to be dividends, is that all that is caught up there?

Mr. HARMER: Yes; along with subsection 3 of section 8.

Section 25 agreed to.

On section 26—employer's payment to pension plan.

Mr. HARMER: At present an employer who makes a special payment into a pension plan because it has not enough funds in it, has to amortize that payment over a period of 10 years. This amendment permits him to claim it all in the year in which he paid it. It also allows any of the payments made in prior years, which have not as yet been deducted, to be deducted in 1958.

Section 26 agreed to.

On section 27—payments to widow, etc. of contributor.

Mr. HARMER: The present law provides that some pensions are not taxable in full because the contributions were not allowed as deductions when they were made by the employee, but only extends this exemption to the employee himself. The purpose of this section is to widen that to extend it to his widow, so that she will not be taxed on it either.

The CHAIRMAN: Is there a cut-off line?

Senator BRUNT: It relates to the contribution made out of what I call tax-paid money?

Mr. HARMER: Yes.

Section 27 agreed to.

On section 28—allocation of credit for dividends.

Mr. HARMER: Under an employees' profit-sharing plan dividends from taxable Canadian corporations received by the trustee of the plan, passing through his hands to the employees, are considered to be eligible for tax credit. Previously there was an arbitrary allocation of these dividends, according to the share of income received by each employee. There were complaints that that was unfair to the persons who had been in the plan longer than others, in that they had a longer entitlement to these dividends, and therefore were entitled to a bigger share of the tax credit. The purpose of this section is to allow the trustee to allocate in a manner in which he deems to be fair, rather than on an arbitrary basis.

The CHAIRMAN: Would you give an illustration of that, Mr. Harmer.

Mr. HARMER: I think Dr. Eaton could better illustrate it.

Dr. A. K. EATON: Mr. Chairman, I don't know that I can do much more than repeat what Mr. Harmer has said. A person who has been in the fund for a long time will have a large part of his allocation to the account each year made up of dividend income, because of the length of time he has been in the fund as it grows up. Now the formula operates unfairly towards such a person, in that he does not get the proper tax credit filtered through in relation to the volume of dividends which he received, as compared with the man who had been in the fund for a comparatively short time.

We did not know how to correct this situation by any formula, so we said to the trustee, "You fix it up," just as we do with the trustees handling foreign tax credits. We ask him to allocate it among the people who are entitled to it, to the extent to which they are entitled. The Department of Revenue hasn't anything to lose, because the trustee cannot give more tax credit than there are dividends, but he can distribute it in a fairer manner than under the present provision.

Senator BRUNT: You will accept his division of the distribution?

Dr. EATON: Yes.

Senator BRUNT: You pass the buck right to him.

Dr. EATON: Yes.

Senator WOODROW: What is the responsibility of the trustee to the department?

Dr. EATON: I don't know that you can say the trustee has any responsibility to the department, except that he cannot allocate more dividend tax credit than there are dividends. He is limited to that, and to that extent he is responsible to the department.

Senator WOODROW: And the department would be satisfied?

Dr. EATON: That is right.

Section 28 agreed to.

On section 29.

The CHAIRMAN: I understand this is a specialty of Mr. MacLatchy, who will explain it.

Mr. MACLATCHY: Mr. Chairman, section 29 relates to registered retirement savings plans. Under the present legislation the plan must provide for an annuity of equal annual amounts over the lifetime of the annuitant. Some companies, however, have been selling annuity contracts that provide, in the case where the wife dies before the annuitant, the husband thereafter would receive a smaller annuity. Under the present legislation such a contract would not qualify as a retirement savings plan. Subsection 1 of section 29 is designed to permit the annuity to be reduced on the death of the spouse without violating the provisions of section 79B.

Subsection 2 of section 29 provides for tax deductions at the source in the case of death of the annuitant before the annuity becomes payable. Under the present law there is a 15 per cent tax on that payment in the event of death; no more, no less, but there is no provision to make it deductible at source.

On subsection 3: one of the clauses put in last year provided that where a plan is not a retirement savings plan because it has not been registered, but is subsequently registered before the end of 1957, it could be treated as a retirement savings plan from then on. By subsection (11) of section 79B the change could take place only prior to the end of 1957. Now, you can change your mind at a later date, and have the plan registered without adverse tax consequences.

The CHAIRMAN: How does this withholding work, Mr. MacLatchy?

Mr. MACLATCHY: In the case of a death before maturity?

The CHAIRMAN: The death of the annuitant.

Mr. MACLATCHY: On the death of the annuitant, the company will refund the money with interest or dividends, or whatever the plan provides for, and the present law provides that the recipient will pay 15 per cent flat tax. This is simply to provide that the tax be deducted at the source and paid direct to the Receiver General, so that the recipient will get 85 per cent of the money.

The CHAIRMAN: That deals with the situation where the annuitant dies before he becomes entitled to any payments out, and all he is entitled to under the plan would be the return of his contributions plus interest.

Mr. MACLATCHY: Yes.

The CHAIRMAN: And the trustee of the plan would pay him 85 and remit 15 per cent to the department.

Mr. MACLATCHY: The only change made here is to provide for the tax to be paid direct by the insurer or trust company to the Crown.

Senator BRUNT: The first type of annuity you referred to would be the type where the wife predeceases the husband and the payment is then cut down.

Mr. MACLATCHY: Right, although there is only one—an English company—that wants that arrangement.

Section 29 agreed to.

The CHAIRMAN: Section 30 stands.

On section 31—Bonus payments.

Dr. EATON: These are for the oil and gas industries. As I recall, they have in the present law the right of deduction as an expense bonus payment for leases where the lease is surrendered completely without production, provided the payments are made to a Government. The present law extends that to bonuses paid for reservations as distinct from leases. A reservation is a hunting licence, really. You take in a big territory with the right to explore, and the

practice has grown up, since we introduced the original law, of auctioning off, if you will, the Alberta law hunting licences as well as lease. This merely extends the law, the deduction for a bonus paid for the reservation if subsequently the whole of the amount reserved, without retaining any, is surrendered to the Crown from which it was originally obtained.

Senator HAIG: What about rentals?

Dr. EATON: Rental payments are always deducted, where there is a private bargain between companies for a higher rental, no more than $1 an acre.

Senator BRUNT: But the recipient pays income tax.

Dr. EATON: The other amendments in this section relate to drilling of certain wells,—you might call them accessory wells. The law allows a company the expense of the well to be drilled for oil. They may now expense the well to be drilled to dispose of salt water, for example. It also allows the expense of drilling a well for water to inject in a well, or gas to inject in a well. It also allows as an expense the well that is drilled in for purposes of injection. That is, they don't drill down the same hole, they drill at an angle and inject water or gas to increase the pressure and bring up the oil. Those three other types of wells, which previously technically were not provided for, now may be expensed along with the original well being drilled.

Senator HAIG: If I own a piece of land that a company thinks there is oil on, and they make a lease with me of $1 an acre, is that taxable?

The CHAIRMAN: It is income.

Dr. EATON: That is rental income received by you as owner of the land.

Senator HAIG: It is rental.

Dr. EATON: Yes.

Senator HAIG: Of course there is rental paid to the Government out of that.

Dr. EATON: Not by you.

Senator HAIG: If the provincial Government puts a tax on oil rights, as in Saskatchewan—

Senator BRUNT: You take it off your rental and pay income tax on the balance.

Senator HAIG: That is what I have been doing, so it is all right.

Section 31 agreed to.

On Section 32—Shares purchased by trustee for employees of corporation.

Mr. HARMER: The law has several rules regarding plans whereby a corporation agrees to sell shares to its employees at a bargain price, but there are some plans where the corporation itself does not sell the shares to the employees. It provides a trustee with money, and the trustee goes out and buys the shares in the market and resells to the employees at a bargain price. This is to make sure that if that happens, the benefit to the employees is taxed in the same manner as if the corporation had sold the shares direct.

Senator BRUNT: It is plugging a loophole?

Mr. HARMER: It is not necessarily a loophole. It is a benefit to the employee, to be caught by this section, because he gets a tax credit of 20 per cent on this benefit. He does not pay any tax unless the benefit exceeds 20 per cent.

Senator BRUNT: But if they dicker with the trustee, as the act now provides, would he be taxed as an employee?

Mr. HARMER: I believe he would be. He would not be entitled to this special treatment.

Section 32 agreed to.

On Section 33:

The CHAIRMAN: What is the purpose of this section?

Mr. HARMER: This is to deny to those taxpayers who were allowed to report their income on a cash basis—that is, as they receive it,—the right to a reserve, which was never intended for them, in respect of amounts which were not earned in a certain year. The reserve was provided to offset the income of a person on the accrual basis who had not yet provided services or goods but had received money. Since the man on the cash basis does not bring income in until he receives it anyway, there is no need for him to have this reserve. This is to make sure he cannot get it.

Senator BRUNT: Have they been getting it in the past?

Mr. HARMER: I have never seen one claimed.

Section 33 agreed to.

On section 34:

Mr. HARMER: The law presently provides a reserve against mortgages owned by loan companies but it does not allow them to claim a reserve against mortgages which they have purchased; only those they take in the first instance. This amendment extends the reserve provisions to allow them the reserve on these purchased mortgages as well as the ones they loan money on.

Senator BRUNT: Are agreements of sale added too?

Mr. HARMER: Yes.

Section 34 agreed to.

On Section 35:

The CHAIRMAN: Now, we bring in sections 30 and 35.

Mr. HARMER: This is a rather involved section, sir, and this statement may help to make it a little more understandable.

The CHAIRMAN: What I will do is read the statement and if I see an expression of understanding on your faces or if you see one on mine you will understand that I know.

Senator HAIG: If you can understand it, Mr. Chairman, we can.

The CHAIRMAN: I was going to say you would be more likely to understand it faster. You will notice that section 35 goes from page 21 to page 27 of the bill. Here is the statement:

> The proposed new section 85 I codifies the practice that has been followed in dealing with cases where there have been mergers of the type defined therein as amalgamations. This type of merger is possible under Ontario and Manitoba laws governing corporations and, from time to time, the Taxation Division has been required to deal with the tax consequences of such amalgamation. It is desirable to state specifically the rules so that those who are contemplating amalgamations may have more certainty about their position.
>
> The proposed section also provides four rules beneficial to the new corporations, that are contrary to the practice previously followed. These are:
>
> 1. The proposed subsection (3) permits a new corporation, under certain circumstances, to deduct drilling, exploration and development expenses incurred by its predecessors.

Senator BRUNT: Is this just for oil companies?

The CHAIRMAN: No, it is general.

Mr. HARMER: But it also covers oil companies.

The CHAIRMAN: The statement continues:

2. Any tax-paid undistributed income of a predecessor corporation at the time of an amalgamation is carried forward as tax-paid undistributed income of the new corporation.

3. Where the predecessor corporations had undistributed income on hand at the end of 1949 but did not avail themselves of the opportunity of paying the 15 per cent tax thereon permitted by section 105(1), the new corporation will be given the right to pay the 15 per cent tax as though it had had a 1949 surplus of the same amount.

4. Where a predecessor corporation did not take advantage of section 105(2) which permits paying the 15 per cent tax on amounts matching its dividends, the new corporation will be allowed to regard those dividends as though it had paid them if it wishes to pay the 15 per cent tax.

That is far as this memorandum goes. One question occurs to me on the point of clarification. If you have a number of companies and any one or more of those companies have what we call a designated surplus, a locked-in surplus, as a result of the change of control of 1950, when the merger takes place my understanding of this statement—and you can tell me whether it is correct or not—is that that designated surplus can go into the new corporation without carrying its burden of tax. Is that right?

Mr. HARMER: I am afraid that you have thought more about this than I have.

The CHAIRMAN: I was only asking a question.

Mr. HARMER: I don't know the answer to that.

The CHAIRMAN: Can you answer it, Mr. MacLatchy?

Mr. MACLATCHY: I am not sure I follow you, sir.

The CHAIRMAN: If you have a series of Ontario companies that are being merged and one or more of them in a position of having a locked-in or designated surplus, and then the merger results, as I understand it that surplus, regardless of its character, whether it is a tax-paid or designated surplus, moves forward into the new corporation without going through the ringer of taxation at that time.

Senator CROLL: What is the theory behind this section?

Mr. HARMER: The theory is that although certain provincial laws provided for these things to happen, our federal law, taxwise, didn't recognize them. We had something emerging out of this process and we did not know what it was or what rights it had and whether certain things disappeared or whether it was a new company or the carrying on of two old ones. These rules are designed to say what does happen in these circumstances. Briefly I think it is merely in most cases, designed to say that what was in two separate corporations before now becomes one.

Senator HAIG: Isn't that what this statement that you have just read says?

Mr. HARMER: Yes. I would point out that paragraph (j) only deals with a corporation which is controlled by the new amalgamation, and if it has a designated surplus it remains designated. But what happens to one that comes into an amalgamation is something else?

Senator EULER: Doesn't it mean that the new company gets the same rates as the old?

The CHAIRMAN: Yes. That is the true theory of a merger. If you have a whole series of companies and press them together, following the merger under our Ontario law you do not require to wind up the so-called predecessor companies; they have all been squeezed into one, so everything carries forward.

Senator POWER: I did not get a proper understanding of the third condition you read from the memorandum just now.

The CHAIRMAN: That was only dealing with the 15 per cent tax:

> Where the predecessor corporations had undistributed income on hand at the end of 1949 but did not avail themselves of the opportunity of paying the 15 percent tax thereon permitted by section 105(1), the new corporation will be given the right to pay the 15 per cent tax as though it had a 1949 surplus of the same amount.

Well, that is the true theory of a merger; everything is squeezed up into one, and what was in three or four companies before becomes only one company, and it does not go into any taxation as a result of the process; it is a true amalgamation.

Sections 30 and 35 agreed to.

On Section 36—How Appeal Instituted.

The CHAIRMAN: Mr. MacLatchy, this is the correcting section that you were referring to a few minutes ago?

Mr. MACLATCHY: Yes.

The CHAIRMAN: So that when the notice of appeal is sent forward by registered mail, that is the method of filing.

Section agreed to.

On Section 37—Service.

The CHAIRMAN: This section also deals with the same subject matter.

Section 37 agreed to.

The CHAIRMAN: Subsection 2 at the bottom of page 27 reduces the amount of the deposit that an appellant has to put up to go to the Exchequer Court, and under this bill it is nominal, being $15. Mr. Harmer informs me that the $15 is not returnable, but I should think the taxpayer would regard it as beneficial.

On Section 38—Duty of Registrar.

The CHAIRMAN: This section defines the duty of the registrar. It is consequential on the previous section.

Section 38 agreed to.

On Section 39.

The CHAIRMAN: Section 39 deals with section 105. This deals with a special situation, I think, does it not, Mr. Harmer?

Mr. HARMER: Yes, under the present law a corporation which wished to take advantage of the 15 per cent tax on undistributed income had to pay on its total undistributed income at the end of 1949 even though since that time it may have incurred losses or paid out dividends which reduced that to a lesser figure. This permits it to pay on the lesser of what it had in 1949 or has now.

Senator BRUNT: They can elect on the amount they have available at the time they pay the tax if they so desire?

Mr. HARMER: Yes, sir.

The CHAIRMAN: How does that work in with your matching dividends after 1949? How do you harmonize the two situations?

Mr. HARMER: Well, they could not match dividends until they had paid tax on their 1949 surplus.

The CHAIRMAN: But if they have a 1949 surplus of $100,000, and say in the year 1956 that has been wiped out, but there have been accumulation since

1949, now you say that with respect to accumulation since 1949 you have to follow section 105(2), which is the matching dividends?

Mr. HARMER: Yes.

The CHAIRMAN: Then what you are saying in relation to the 1949 surplus, is that if bad years after 1949 have reduced the amount of that or you have paid some of it out in dividends, then you can clear the balance by paying 15 per cent?

Mr. HARMER: Yes.

Senator BAIRD: That is section 95(a)?

The CHAIRMAN: Well, it was 95(a); it is now called section 105.

Senator BAIRD: In other words, if a person acted under section 95(a) and they got a surplus since that time, are they permitted to withdraw that surplus by paying a tax of 15 per cent?

The CHAIRMAN: No.

Senator BAIRD: Well, if they have not declared any dividends they are not entitled to anything?

The CHAIRMAN: Well, there is a method; they can pay out and match, yes. But section 39 is limited. If you want to disburse 1949 earnings at the end of 1949 in the year 1957, when this bill becomes law you can do it by paying 15 per cent on what you have left of the 1949, rather than with all the amount that you had at the end of 1949. Isn't that right?

Mr. HARMER: That is correct.

Section Agreed to.

The CHAIRMAN: Subsection 2 is consequential.

Some SENATORS: Carried.

The CHAIRMAN: Subsection 3 is also consequential.

Some SENATORS: Carried.

The CHAIRMAN: Subsection 4, on page 29. Would you explain that, Mr. Harmer?

Mr. HARMER: Well, the present law prohibits a subsidiary controlled corporation from matching its dividends, because any dividends it pays are not taxable. However, there are some subsidiary controlled corporations that became such after 1949. The object of this is to allow them to match dividends which they paid before they became subsidiary controlled corporations, which dividends would have been taxable.

The CHAIRMAN: Well, that is beneficial.

Some SENATORS: Carried.

The CHAIRMAN: Then subsection 5 is consequential.

Section 39 agreed to.

On Section 40.

Dr. EATON: This is to take care of a company which was an ordinary operating company before it became a non-resident owned investment corporation, an investment corporation that cannot carry on business, and during that period it had accumulated and earned surplus; then it became a non-resident owned investment corporation. Now, a non-resident owned investment corporation is taxable currently at 15 per cent. As the income moves out there is no tax. The 15 per cent non-resident tax is moved inside the boundary and put on currently on the corporation, and when the income moves out there is no tax. Now, in the case of a company that had an earned surplus before it became one of these things it moves into this position of paying 15 per cent currently and pays nothing on the movement out of funds. When

it acquires that status then it is in the position to pay out all that accumulated surplus without a 15 per cent tax, which was never intended. It was only intended that what had borne the 15 per cent tax would move out from that which had accumulated. Now it bears the 15 per cent tax and this is to ensure that the dividends move out only if the amount of the surplus accumulated when it became one of these things has moved out and borne the tax.

The CHAIRMAN: What about the reverse situation? What about the company that starts out as a non-resident corporation and has accumulated a surplus which it might pay out at any time without tax but it has not paid it out, and then it became a regular corporation? Would it likewise, in reverse, in those circumstances carry forward that same tax on the portion of the surplus accumulated after it became a regular corporation?

Dr. EATON: No.

Senator BRUNT: Tidy that up next year.

Dr. EATON: It gets a 15 per cent tax instead of a 47 per cent tax. Currently it pays only 15 per cent, then it becomes an ordinary corporation and pays 47 per cent.

The CHAIRMAN: But I am talking about the disbursement. Can you distinguish between the surplus that accumulated when it was a non-resident owned company as against when it was an incorporated company? It seems to me that the surplus of a non-resident owned investment corporation is in the category of a tax paid surplus, that it might go out at any time without further tax. Now, does it lose that benefit when it becomes a regular company?

Dr. EATON: I think it does the way it stands, but whether it should or not it is too late for me to answer that.

Senator BRUNT: I am still right—next year you can tidy that up.

Section 40 agreed to.

The CHAIRMAN: Now we come to section 41. Mr. Harmer, have you anything to say on this?

Mr. HARMER: Nothing that has not already been said, Mr. Chairman.

Senator MACDONALD: This is a section which covers the case of where I make a gift of real property to the extent of $10,000.

The CHAIRMAN: Yes.

Senator MACDONALD: The question was raised in the house by me whether a man and his wife had to continue to reside in the premises and make it their home. A spouse makes a gift of a $10,000 home, and it is their home for the next week when they sell the house and move into an apartment.

The CHAIRMAN: Surely once they recognize it as a gift they do not take it back, do they?

Senator MACDONALD: I do not know.

The CHAIRMAN: Mr. Harmer would you care to express any view on that?

Mr. HARMER: It is a very interesting question. As I read the law it just says that it has to be used and it does not say for a month, an hour or a day or a week.

Senator ASELTINE: There is no time limit.

The CHAIRMAN: I know, but in the case of a gift to the spouse as a place of residence, if the husband is a donor and made a declaration in writing of his gift and the purpose of it, does that satisfy the requirement of the statute, or do they have to move in?

Mr. HARMER: I think we would accept it.

The CHAIRMAN: I think a declaration of intention if it is honestly made would be accepted. Who can foresee the circumstances in the future?

Senator MACDONALD: That is right. A great many people move out of a home to live in an apartment.

The CHAIRMAN: That is right.

Senator BRUNT: Senator Power raised the point that this does not apply in the province of Quebec. Is that correct?

The CHAIRMAN: That is because of Quebec law.

Senator POWER: Have you done anything to try to soften the blow on Quebecers?

Senator BRUNT: Or even it up?

Senator LEONARD: Mr. Chairman, I just wanted to see what would be the effect in a case that I think is quite common where a father may help a son acquire a farm and instead of making the gift outright at the time, he probably lends him $5,000 or $10,000 and takes a mortgage on the farm until the son gets established, and he may want at some time to give a discharge of that mortgage to the son. Let us take the case of the $10,000 mortgage. Is that discharge of the mortgage a gift within this section?

Mr. HARMER: It has to be an interest in real property, Senator Leonard, but I do not know.

Senator LEONARD: You do not consider that a mortgage qualifies as an interest in property? That is a question I would like an answer to.

Mr. MACLATCHY: In the common law provinces I think that would be an interest in real property.

Senator LEONARD: Then your answer is, in the case I have given, it would qualify as a gift if he gives a discharge of that mortgage?

Mr. MACLATCHY: In effect a discharge of a mortgage is a transfer of the legal title to the property.

Senator LEONARD: I raise the question by way of draftmanship because it says:

> a gift to the spouse or child of the donor of an interest in real property—

and then it goes on to speak of a transfer, assignment or other disposition of that property, and does not use the words again, "interest in real property". It raised in my mind a question of whether it really did mean the fee in the property or the title in the property rather than the disposition of the interest in the property, that is a discharged mortgage, for example. If the words are intended to cover the transaction that I have described as a gift, it would seem to me that it should say, by way of a transfer, assignment or other disposition of that interest in the property.

The CHAIRMAN: I think so too, senator. What do you say Mr. MacLatchy?

Mr. MACLATCHY: I do not think the situation was thought of when the section was drafted. This proposition was made to me recently and after some consideration it was my opinion that it would be covered by the section, because the discharge of the mortgage I think would be in effect a transfer of the fee.

The CHAIRMAN: You speak of an interest in real property and then go on to say, "made by way of a transfer, assignment or other disposition of that property." Is that not of interest in real property?

Mr. MACLATCHY: I think it means the same thing.

Senator LEONARD: I just wanted to be sure that the transaction is intended to be covered, and the opinion of counsel is that the wording does cover that transaction.

Senator POWER: What if the father just simply lends his son $10,000 and then says, "forget about it."

The CHAIRMAN: That is not under this section.

Senator POWER: The son buys the property with it. I am talking about the case where the son buys a property and the father gave him $10,000 and afterwards tells him to forget about it.

The CHAIRMAN: I think what the father would have to do is to buy the property and give it to the son.

Dr. EATON: If I may comment on that point, there is the ordinary gift tax exemption of $4,000 a year, which can be used to discharge a debt, and a father can take a note and then forgive it. This provision is in addition to the $4,000 a year without gift tax.

Senator LEONARD: Provided there is an interest in real property.

The CHAIRMAN: Yes.

Senator GOUIN: Mr. Chairman, as you know, in Quebec, we have gifts *inter vivos* only by marriage contract. My first question is, would this apply to a gift by marriage contract? A future husband gives to his future wife, under a marriage contract, without separation as to property, joint ownership in the house in which they are going to live. My impression would be that that would apply.

The CHAIRMAN: It says, a gift to the spouse or child.

Senator GOUIN: This is just in the case of a gift to the spouse.

The CHAIRMAN: The intended spouse.

Senator MACDONALD: It takes effect after marriage.

The CHAIRMAN: I would not presume to express an opinion on it; it would be a matter of contract.

Senator GOUIN: In this case it would be the future husband, and the contract takes place only when the marriage takes place.

Senator BRUNT: Can this not be done now in Quebec, without this section, and no tax attaches to it?

The CHAIRMAN: Senator Power, you were one who said this section was of no benefit.

Senator POWER: I am inclined to agree with Senator Gouin's example that, to the extent of $10,000 there could be a gift, and it would be covered. If a future husband, in consideration of marriage, undertook to give $10,000 to a future spouse, I am wondering if during a marriage the husband could give another $10,000 with no gift tax on it. That, I don't know.

Senator GOUIN: It is only because she is his future spouse; the contract would take effect only with the celebration of the marriage. And further, Mr. Chairman, the bill would allow a gift to the children to be born of the marriage.

Senator ASELTINE: Why could not the husband ratify the contract after marriage?

Senator LEONARD: Would the gift take effect if the marriage did not take place?

Senator GOUIN: No, not under the marriage contract.

Senator POWER: I am not expressing myself one way or the other, because I do not know enough about it.

Section 41 agreed to.

On section 42—refund.

Mr. HARMER: This provides for the refund of a gift tax within three years of death, when there is no succession duty.

Senator POWER: This would seem to be beneficial. Is it beneficial?

The CHAIRMAN: Yes, it is. By way of illustration, Mr. Harmer, let us assume a man made a gift of $40,000 within three years of his death, and paid a gift tax on it.

Mr. HARMER: Yes, and when he died, he did not leave enough estate, including the $40,000, to be taxable. In those circumstances what tax he had paid by way of gift tax would be refunded.

Senator POWER: If he makes a gift a day before he dies, and pays a gift tax of roughly of 25 per cent, would that not go into his estate?

The CHAIRMAN: The point is, if he should die within three years of having made a gift, not leaving a taxable estate including the amount of the gift, then a refund is made of the gift tax. Is that right?

Mr. HARMER: Yes.

Dr. EATON: The reason is that gift tax was put on to prevent evasion of estate tax. So, if there is no estate tax, why a gift tax?

Section 42 agreed to.

On section 43.

Mr. HARMER: This is connected with an earlier section, increasing the period for refunds from two years to four years. This section previously covered both non-resident tax refunds and wage tax refunds; now it is being made applicable only to non-resident tax, and maintains the two-year limit.

The CHAIRMAN: In connection with non-resident tax, you keep the two year limitation as to refunds, whereas for residents it is four years.

Mr. HARMER: Yes.

The CHAIRMAN: Shall I report the bill without amendment?

Some SENATORS: Carried.

Bill reported without amendment.

—Whereupon the committee adjourned until Wednesday, August 27, 1958 at 10.30 a.m.